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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1928.

No. ~~360~~ 59

MABEL G. REINECKE, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF ILLINOIS,
*Petitioner.*

*vs.*

EUDORA HULL SPALDING,
*Respondent.*

## BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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## BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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### I.

There is no reviewable error presented by any assignment of error in the record.

To show this point it is necessary, in the absence of any statement in the petition as to how any error is claimed to arise, to state that this action was brought to recover income tax unlawfully exacted from respondent in the years 1917 and 1918, which taxes were imposed upon iron ore royalties fixed in leases prior to March 1, 1913 at 25 cents per ton. The law in 39 Stat. at L., 756, Part I, Individuals, Section 1 (a), provides for a

tax upon the net income of individuals. It also provides, in order to ascertain such net income, a deduction for depletion of mines fixed in Section 5 (a), quoted in the petition (p. 2), with reference to "the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made."

The statute for 1918 (quoted in Petition, p. 3), while differing in words, does not differ in effect, for both acts have Section 2, 39 Stat. L. 758:

> "(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal or mixed, acquired before March 1, 1913, the fair market price or value of such property, as of March 1, 1913, shall be the basis for determining the amount of such gain derived." (This section is quoted *Lynch* v. *Alworth Stephens Co.* 267 U. S. 364, 368.)

The property disposed of is iron ore. The passing of title, on sale or disposition of ore from lessor to lessee under the leases, takes place upon extraction and not until then.

> *United States* v. *Biwabik Mining Co.* 247 U. S. 116.

It is apparent that the disposition of ore when extracted under a lease is a form of sale or disposition of property as a capital asset and the basic capital value is "market price," March 1, 1913.

The cause was tried to a jury. At the end of all the evidence the defendant, now Petitioner, moved for an instructed verdict for defendant, and plaintiff, now Respondent, made a counter-motion for plaintiff (Printed Rec., 55), and there being no question as to amount of the verdict, if for plaintiff (Printed Rec., 56), the court stated that the effect of the motions was a submission of

the facts to the court for decision (Printed Rec., 56), and thereupon instructed the jury to find for the plaintiff, and to assess plaintiff's damages at the sum of $118,043.12, to which the defendant excepted (Printed Rec., 57). The defendant made no request to go to the jury either before or after the ruling made, nor asked any withdrawal of its peremptory request after it was ruled upon.

The case of *Buetell* v. *Megone*, 157 U. S. 154, 157, is controlling, an exactly similar case, which holds:

> "The facts having been thus submitted to the Court, we are limited in reviewing its action, to consideration of the correctness of the finding on the law, and must affirm if there be any evidence in support thereof." (Citing cases.)

The case of *Empire State Cattle Co.* v. *Atchison, etc. R. Co.* 210 U. S. 1, has no bearing here.

The sole matter that can be assigned for error on such a record as this, is that there was no sufficient evidence to sustain the finding. In the assignment of errors in the Circuit Court of Appeals there is no such error assigned. (Printed Rec., 213.) If, however, such error had been assigned, this Court would not depart from its rule that where the facts are found in the trial court and confirmed in the Circuit Court of Appeals, this Court will not search through the record to find whether the finding as made in the courts below is supported by the evidence.

The petition for certiorari (p. 8), in its statement of error, does not refer to any assignment of error relied upon, and does not say or assert that there is not evidence in the record to support the finding of the District Court. It results that the assignment of error necessary to review this record is not in the record.

Even if there was such assignment and the Court should be disposed to pass on the evidence, a writ of cer-

tiorari ought not to be granted, for the only review that can be had is whether there is any evidence to support the finding, and that there was such evidence and no other evidence is apparent from the record. To this matter is the next point.

## II.

As to whether there was evidence to support the finding of the lower court, there ought to be no question on this record.

The thing that is being disposed of is ore which had a market value provable as a fact and such fact was proven for all material dates.

The case for the plaintiff on the law was to show the basis of depletion, which was stated in *Lynch* v. *Alworth-Stephens Co.* 267 U. S. 364, 370, construing the statute in a case where depletion of both lessor and lessee was involved:

> "There is an exhaustion of property in the one case as in the other; and the extent of it, with the consequent deduction to be made, in each case is to be arrived at in the same way; namely, by determining the aggregate amount of the depletion of the mines in which the several interests inhere, based on the market value of the product, and allocating that amount in the proportion of the interest of each, severally considered."

Having determined this "market value in the mine of the product which has been mined and sold during the year," (quoting statute), the next thing is to determine the market value of that product on March 1, 1913, for, if the market value had increased since March 1, 1913, under these leases existing prior to March 1, 1913, there was a profit on capital on the sale or disposition, if the sale was at an increased market value. Both market values

were proven to be at least 25 cents per ton (Printed Rec., 31, 32, 34, 36), so there could be no capital profit in a disposition of the ore at 25 cents per ton, except as capital interest was contained in the royalty payments as deferred from March 1, 1913, to the date of payment, for every payment for capital deferred without interest contains in itself both principal and interest thereon for the deferred period.

*Foley* v. *Fletcher*, 3 H. and N. 769;
*Secretary of State* v. *Scoble* (1903), A. C. 299, in income tax cases.

The evidence in the record consists of the income tax returns of the plaintiff for the years 1917 and 1918 (Printed Rec., 29, 59-73, 75-80); the total tonnage extracted from all the mines in 1917 and 1918 (Printed Rec., 30), and the plaintiff's part of the extraction as one-sixth thereof (Printed Rec., 30); and the leases, so-called, made prior to March 1, 1913, fixing a royalty of 25 cents per ton (Printed Rec., 37, 90-170) and the plaintiff's one-sixth interest in the extracted ore. By reason of the leases plaintiff's interest could not exceed 25 cents per ton on one-sixth of the tonnage extracted or one-sixth of 25 cents on all tonnage extracted. It was admitted on the record that the plaintiff made her original returns in good faith, without any intention to defraud. (Printed Rec., 38.) The plaintiff proved by competent witnesses that the ore in the mine on March 1, 1913, was merchantable iron ore, unusually good in quality, containing fifty-four per cent of iron and that the fair market value of each ton of ore then and there in the mine, untouched and unextracted, was on March 1, 1913, and thenceforward throughout 1917 and 1918, and throughout 1917 and 1918, and throughout the intervening time, at least 25 cents per ton. (Printed Rec., 31, 32,

34, 36.) The plaintiff offered in evidence the papers showing what she had been compelled to pay as income tax for the years 1917 and 1918, and the claims for refund duly made. Then she offered in evidence calculations showing the amount of income tax overpaid (Printed Rec., 43, 44), and an accountant testified, as to the sums paid quarterly in the years 1917 and 1918, how much thereof was principal and how much was interest at the rate of five per cent for the period of deferment of payment from March 1, 1913, up to the date of payment (Printed Rec., 46, 47).

The plaintiff had thus shown as a basis of capital depletion the market value of the product mined and sold during the year, that the market value of March 1, 1913, was not exceeded in the sale or disposition of the extracted ore, but was reached, and that all of that market value was capital on March 1, 1913, except the amount therein contained which represented interest on the payments deferred from March 1, 1913, which interest had been shown, and the remainder was necessarily capital depletion.

Thereupon, the defendant put upon the stand a witness who was asked (Printed Rec., 50) what was the customary method in the mining industry of determining depletion, which does not seem to be material, and the witness said, "we take the value of the mine of March 1, 1913, and the tonnage of ore in the mine as of that date, and divide the value of the mine by the tonnage to get a factor to be used for depletion, then in any one year the number of tons of ore extracted in that year times the factor give us the amount of the depletion for that year." (Printed Rec., 52.) The witness also stated in answer to the court that there are two things to determine, a figure which represents the tonnage of the mine, and the figure that has been ar-

rived at as to the value of the mine, and the witness said that he did not intend to make any statement as to how to ascertain the value of the mine. (Printed Rec., 52.) This left uncontradicted the value of the ore bodies proven as to ore disposed of in the year of extraction and on March 1, 1913, the basic date, of 25 cents a ton. No attempt was made by this witness to show any other value to the ore bodies except that proven by the plaintiff's witnesses. No other witness was sworn for the defendant.

The Petitioner asserts now that market value of the ore in the mine is not the proper measure of the value of the capital asset but on that point no evidence whatever was offered by the defendant. The evidence of plaintiff was uncontradicted, and the District Court found on that evidence as the only evidence, and its finding is unassailable as has been shown.

In the Circuit Court of Appeals, reliance was placed upon the figuring of accountants in the income tax department used to fix the tax. That method of figuring was disposed of in the opinion of the Circuit Court of Appeals in this case *Reinecke, Collector* v. *Spalding,* 30 Fed. (2d) 369. But on the trial the counsel for the defendant had stated that this "method used by the Commissioner is entirely immaterial in this case." (Printed Rec., 39.) Since the defendant offered no evidence at all to show the correct method of determining the market value of the ore, and asserted that the Commissioner's calculation was immaterial, the trial court could do nothing else under the Government's contention than decide upon the evidence as it stood and the evidence supported his decision.

In the petition for certiorari, the Petitioner asserts (p. 8) that:

"The proper allowance should be computed by de-

> termining the percentage of the whole reserve which was withdrawn and paid for during the taxable year, and taking this same percentage of the plaintiff's capital investment, that is, of the March 1, 1913, value of the plaintiff's interest in the mine. In other words, the depletion in dollars is the same percentage of the capital investment as the depletion in tons is of the whole reserve."

This is precisely the method followed in the lower court. We are to ascertain the depletion of Respondent's undivided one-sixth interest in an ore body. The market value on March 1, 1913, is the measure, which is limited however by the leases to 25c per ton. The proof was full and uncontradicted that the market value on March 1, 1913, and at all times thereafter through 1918 was at least 25c per ton. This was a fact of market value at the time and place. (Printed Rec., 31, 32, 34, 35.) The petitioner's claim is merely another way of stating the finding of the lower court. Eliminating for the moment the question of interest, the lower court gave as depletion for each year an amount in dollars bearing the same percentage to the market value of the respondent's total ore body on March 1, 1913, as the tons extracted bore to the respondent's total tonnage in the mines. We may take an illustration, using for convenience small figures. If the assumed ore reserve in the mine is 600,000 tons, the respondent's one-sixth undivided interest is 100,000 tons. The market value of each ton on March 1, 1913, and thereafter through 1918, was at least 25c per ton, and the value of respondent's interest was $25,000, being limited to that because of the leases. If the extraction in 1917 was 120,000 tons, respondent's share was 20,000 tons. The percentage of the whole reserve withdrawn in 1917 was 20 per centum. Taking this percentage of the respondent's capital value gives $5,000, which is precisely what the lower court allowed except that it

took out of such amount interest from March 1, 1913, to date of payment because such payment was deferred. Any other assumed extraction and any other assumed reserve, will give precisely the same result, and this is precisely what Petitioner states and what Respondent claims and the lower court granted.

So far as the record shows this method is in accordance with the regulations of the department, and there was no violation of those regulations by the lower court (see page 4, 5, of Petition). The depletion on the value of the property in the ore on the basis date, March 1, 1913, was determined by applying that basic value to the product of the year of the return according to the regulation. Preference was given to the principal or customary unit paid for the product sold, for that is a market value. This is according to the regulation. The amount of capital applicable to each unit was determined as stated in the regulation, and that unit applied. In fact, there was no contradicting testimony. On the lower court's allowance of depletion with interest deducted out of depletion on deferred payments, the depletions in successive years can never reach the market value of the whole body of ore in the mine, whatever it may be. The best feature of the statute as applied by the court in this case is that the method of the statute and the regulation thereunder works, whatever the suspected reserve, *i. e.*, ore in the ground, may be.

The Commissioner has issued a regulation which can be lawfully used so that no capital will be taken as income, but the same regulation, if arbitrarily used, can make, by arbitrary figuring, regardless of market value facts, a value for the ore in the mine on March 1, 1913, that is less than the standard of the law, which is the market value. But it is the settled law that under the

guise of an income tax no part of the capital value can be taken as income.

*Doyle* v. *Mitchell Brothers Co.* 247 U. S. 179.
*Eisner* v. *Macomber,* 252 U. S. 189.

The fact that the regulations of the Commissioner can be and have been used in a lawful manner by the lower court in arriving at depletion, is no reason why the Government should complain because those same regulations might have been used by arbitrary figuring in an unlawful manner to reach an unlawful result by taking capital as income. "The law is good, if the law be lawfully used."

It is asserted in the petition that the amount of depletion of mines, if any, is discretionary with Congress. This is a total error. If an excise tax is laid on the product of mines, the amount of either depletion or depreciation to be allowed is, under former rulings, discretionary with Congress. But under an income tax law, the authoritative decisions are that no part of the capital can be taken as income, because it is not permitted by the terms of the Constitutional Amendment, or by the terms of an income tax law itself. (See cases last *supra.*)

It is said in the petition that the decision here contradicts the case of *New Creek Company* v. *Lederer,* 295 Fed. 433, and the case of *United States* v. *Ludey,* 274 U. S. 295. The *Lederer* case was a case where the question here did not appear at all, but no allowance for deferred payments on interest was taken from depletion, and the whole product of the mine was claimed as depletion, although there were deferred payments. In the *Ludey* case the question was, upon a sale of capital assets, whether depletion allowable or depletion taken was to be deducted from the cost price in order to ascertain

how much the selling price exceeded the cost price, in ascertaining the profit on a sale.

The Ludey case is stated on page 14 of the petition, according to the Government's construction of it, "namely, that each ton of ore in the mine represents a proportionate part of the taxpayer's capital investment and that, accordingly, the extraction of one ton of ore depletes the taxpayer's capital in the same proportion as it depletes the mineral content." This is what the lower court decided in fact. The tonnage is being disposed of and each ton's market value not exceeding the March 1, 1913 value depletes the capital investment in the same proportion that the tonnage extracted depletes the total tonnage, whatever it is.

The statement on page 13 of the petition ought to be the exact opposite of what it is, for the allowance permitted by the Circuit Court of Appeals in this case cannot result in the return of the taxpayer's entire capital prior to the exhaustion of the mine. It can not result in his never receiving tax-free his whole capital investment, and it must result in his receiving back the last of his capital investment with the exhaustion of the last of the ore and it must result in a return of capital in step with actual exhaustion. No other result is possible. The fact that such is the result is the reason why the statute is just.

All the statements made in the petition, as to the effect of this decision is reversing the regulations or calculations heretofore used, are based upon no evidence in the record except certain abstruse calculations which the counsel for the plaintiff in the lower court expressly repudiated and which are not in the petition relied upon. The petition itself shows that the method adopted by the lower court was correct. It has been shown that the

regulations were followed word for word in determining market values and the unit of depletion per ton. Nowhere in this record can be found what other rule, if any, for ascertaining values, the Government contends for. This petition for certiorari seems to be based on the proposition that a certiorari should be allowed in a case in order to determine the correctness of some method of ascertaining market value which was never put before the lower court, and which is not stated now. In other words, the judgment of the lower court ought to be reviewed for the purpose of trying some other case than the one which was actually tried.

We submit that the petition and the accompanying brief show no ground for the issuance of a writ of certiorari.

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